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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1960

No. 1005

VIRGINIA ELECTRIC AND POWER COMPANY,

Appellant,

v.

WILLIAM A. JOHNSON, COMMISSIONER OF REVENUE OF NORTH CAROLINA,

Appellee.

APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA

STATEMENT AS TO JURISDICTION

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Dated April 14, 1961.

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STATEMENT AS TO JURISDICTION

I.

OPINION BELOW

The opinion of the Supreme Court of North Carolina (reprinted in Appendix C hereto) is reported in 254 N. C. 17, 118 S. E. 2d 155.

II.

JURISDICTION

This is a proceeding authorized by North Carolina statutes to recover excessive income taxes paid by the Appellant to the State of North Carolina in respect of the calendar year 1953. Similar cases in respect of each succeeding tax year are either pending in the North Carolina courts or before administrative tax officials.

The judgment of the Supreme Court of North Carolina (Appendix D) was entered on February 3, 1961. Notice of Appeal was filed in that court on April 5, 1961.

The contention of the Appellant, here as in the courts below, is that § 105-134 of the North Carolina General Statutes in effect for the tax year 1953 is, as applied by North Carolina to the Appellant, in violation of the Constitution of the United States. The jurisdiction of this Court is invoked under 28 U. S. C. §§ 1257(2) and 2101(c) (1958). The former confers jurisdiction on this Court by way of appeal when the constitutionality of a State statute is brought into substantial question.

This Court customarily receives cases from State courts relating to the constitutionality of State taxing statutes by the appellate route. *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U. S. 450 (1959); *Butler Bros.* v. *McColgan*, 315 U. S. 501 (1942); *Norfolk & W. Ry.* v. *North*

Carolina, 297 U. S. 682 (1936). A State decision enforcing a State statute in a particular transaction against a timely claim of Federal right is subject to review on appeal. *Fiske* v. *Kansas*, 274 U. S. 380, 385 (1927). That is the situation in this case.

III.

STATUTES INVOLVED

The substantive statute levying the tax is § 105-134 of the North Carolina General Statutes as in effect in 1953. This is § 311 of the Revenue Act of North Carolina (N. C. Sess. Laws 1939, ch. 158) as amended through the 1953 session of the General Assembly of North Carolina (N. C. Sess. Laws 1953, ch. 1302, § 4, pp. 1291-95). The procedural section authorizing this action is § 105-267 of the North Carolina General Statutes as in effect in 1955 when this suit was instituted. That is § 936 of the Revenue Act as amended to 1955 (N. C. Sess. Laws 1955, ch. 1350, § 15, pp. 1411-12). Pertinent excerpts from both sections are appended hereto as Appendix A.

IV.

QUESTION PRESENTED

Only a single question is presented:

Does the North Carolina income tax statute, as applied to the Appellant's business, attribute to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the Appellant in North Carolina, and is the statute therefore void as so applied as in violation of the due process and commerce clauses of the Constitution of the United States?

The answer to this question is in the affirmative.

V.

STATEMENT OF THE CASE

The Appellant is an electric utility, generating energy primarily in Virginia and distributing it throughout much of Virginia and portions of North Carolina and West Virginia. It also distributes natural gas in the Hampton Roads area of Virginia.

North Carolina's income tax statute provides that, in the case of an electric utility, net income shall be allocated to North Carolina on the basis of the relationship of gross receipts received from North Carolina business to total gross receipts. Provision is made for appeal to the Tax Review Board which may permit assessment of the income tax on a separate allocation basis by States or by addition of the payroll factor to, or substitution of it for, the gross receipts factor. The Appellant, as a regulated utility, must keep on its books of account a detailed allocation of receipts and expenditures by States, and such allocation is accepted by North Carolina for utility rate making purposes.

The North Carolina tax officials required the Appellant to segregate its gas business, located solely in Virginia, by a separate accounting identical in principle to that used for allocation between States. The Appellant did not object to this step.

After taking this first step, the Appellant found the following to be the facts:

Allocation Method	Income Allocated to North Carolina	North Carolina Income Tax
Gross Receipts	$1,292,911	$77,574.66
Average of Gross Receipts and Payroll	1,092,471	65,548.27
Payroll	892,031	53,521.86
Separate Allocation by States	317,114	19,026.84

The Appellant, in view of the utter disproportion of these figures, sought relief from the Tax Review Board. The Board authorized the use of the average of the gross receipts and payroll factors. The tax so determined was paid under protest. Suit was instituted in the Superior Court of Wake County, North Carolina. The refund requested was in the amount of $50,243.14 plus interest. The constitutional issue was raised in the initial pleading and has been argued and considered at all subsequent stages of the case.

At the hearing the Appellant presented two witnesses. The first witness showed why the business of the Appellant in North Carolina was relatively unprofitable; the area served is primarily rural without urban communities of consequence as compared to the more urban and industrialized territory served in Virginia. Investment per customer is almost twice as heavy in North Carolina as outside, and revenue per kilowatt hour is lower despite identity of rates. Taxes, excluding income taxes, are higher proportionately in North Carolina than elsewhere. All of these indicators made it clear that neither the gross receipts[1] nor the payroll factor could properly measure the profitability of the Appellant's North Carolina operations.

The testimony then continued to show the result based on an allocation of receipts and expenditures to North Carolina. No allocation was necessary as to receipts, for actual North Carolina receipts were known. The allocation of expenditures was made in accordance with the same principles adopted by the North Carolina tax officials in excluding the gas business from total operations and the same principles have been accepted by the North Carolina Utilities Com-

[1] ". . . the original and crudest measure of allocation. . . ." Studenski, *The Need for Federal Curbs on State Taxes on Interstate Commerce: An Economist's Viewpoint*, 46 Va. L. Rev. 1121, 1147 (1960).

mission in establishing the Appellant's electric rates. This allocation is made annually and its results are actually entered on the Appellant's books of account. There was no substantial question raised as to its propriety.

Both courts below rejected the Appellant's contentions and upheld the taxing officials. Both considered and overruled the constitutional objections. The case is now here for those objections to receive their ultimate test.

VI.

THE FEDERAL QUESTIONS ARE SUBSTANTIAL

If the rule were that an apportionment formula, fair on its face, raises no constitutional issue even if its application to particular circumstances produces a manifestly unfair result, this case would not be in this Court. No contention is made here that apportionment by the gross receipts factor or by the payroll factor or by the average of the two is so obviously unfair on its face as to result in unconstitutionality of the statute; our claim is that their application in this case permits North Carolina to tax income proven to be derived from Virginia.

The rule of law has been clearly established by this Court:

> "[T]he statutory method, as applied to the appellant's business for the years in question operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State. In this view, the taxes as laid were beyond the State's authority." *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U. S. 123, 135-36 (1931).

That exact language applies here, and a result quite simi-

far to that overturned in *Hans Rees* was upheld in this case by the courts below.

The rule of *Hans Rees* has never been modified. The cases decided by this Court before and after that decision rest on evidentiary determinations. *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113 (1920), was decided against the taxpayer because it did not show the income reasonably attributable to the taxing State. In *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U. S. 271 (1924), the taxpayer showed that it had no net income in the United States as a whole but failed to prove that it had no net income in the taxing State. In *Norfolk & W. Ry.* v. *North Carolina*, 297 U. S. 682 (1936), there was evidence as to expenses but no evidence as to revenues. In *Butler Bros.* v. *McColgan*, 315 U. S. 501 (1942), Mr. Justice Douglas made clear the failure of proof when he said:

> "Admittedly, centralized purchasing results in more favorable prices being obtained than if the purchases were separately made for the account of any one branch. What the savings were and what portion is fairly attributable to the volume contributed by the San Francisco branch do not appear." (315 U. S. at p. 508)

In this case there is no evidentiary flaw. Here is the "clear and cogent evidence" that *Butler Bros.* demands (315 U. S. at p. 507). The Supreme Court of North Carolina found to the contrary, but its determination of facts is subject to review by this Court.[2] This Court has in other tax cases such as this invariably pointed to the evidentiary flaw; the Supreme Court of North Carolina did not do so and it could not do so, for none exists.

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[2] *In re Sawyer*, 360 U. S. 622 (1959); *Hooven & Allison Co.* v. *Evatt*, 324 U. S. 652 (1945); *Great No. Ry.* v. *Washington*, 300 U. S. 154 (1937).

The question of the proper basis for State income taxation of the multi-State corporation is one of the major legal and economic questions facing the nation today. The States, striving as they must to increase sources of revenue, have been reaching ever further to tax the foreign corporation. When they go beyond the bounds established by previous decisions of this Court, their efforts tend to stifle the legitimate expansion of free enterprise and therefore to threaten the common market that is the United States. It is important that this Court speak again as to the line that must be drawn between proper and improper State action.

This question has become particularly acute since this Court's recent decision in *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U. S. 450 (1959). Hardly half a year later, the Congress acted to limit State action in the multi-State taxation field.[3] It also directed the Senate Committee on Finance and the House Committee on the Judiciary to hold hearings and report proposed legislation to provide uniform standards to be observed by the States.[4] The resulting volume of literature is impressive.[5] A substantial number of cases concerning various facets of the problem have arisen and been decided.[6] One, involving principles almost identical to those raised in this case, is now pending in this Court.[7]

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[3] Pub. L. No. 86-272; 73 Stat. 555-56, 15 U. S. §§ 381-384 (Supp. I, 1959).

[4] Pub. L. No. 86-272, § 201, 73 Stat. 556 (Sept. 14, 1959).

[5] No complete catalogue would be useful. But see *Symposium on State Taxation of Interstate Commerce*, 46 Va. L. Rev. 1051 (1960).

[6] See, among others, *Armco Steel Corp.* v. *Michigan*, 359 Mich. 430; 102 N. W. 2d 552 (1960), *appeal dismissed*, 364 U. S. 337 (1960), and *Mississippi State Tax Comm.* v. *Tennessee Gas Transmission Co.*, 116 So. 2d 550 (Miss., 1959), *appeal dismissed*, 364 U. S. 290 (1960).

[7] *Walgreen Co.* v. *Commissioner of Taxation*, 104 N. W. 2d 714 (Minn., 1960), pending on appeal to this Court, Docket No. 732.

It is difficult to imagine a question of greater econom importance at the present time than that presented by th case. The States will continue to encroach on legitima business and balkanize the United States unless this Cou establishes limitations to their authority. In this case, f example, the effective tax rate has, by administrative acti been raised from the 6% established by the statute to mo than 20% of the actual net income that the Appellant earn in North Carolina. Taxes at such rates, when added others levied by the same and other jurisdictions, damage t public interest by making service unprofitable. Unprofitab service tends to become inferior service that is not willing expanded or improved as public need requires.

The constitutional question raised in this case is ve substantial. It deserves plenary consideration by this Cou

VII.

CONCLUSION

The field of State taxation of the multi-State corporati is at the moment one of chronic unrest. Tax administrato all over the country need guidance from this Court. Th can be given by a full consideration of this case. It gives t Court an opportunity not only to revitalize established leg principles but to settle, in part at least, economic turbulen that now affects our economy. This case is worthy of revie by this Court.

Respectfully submitted,

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Dated April 14, 1961.



APPENDIX A

Statutes Involved

1. The Substantive Section

The taxing statute, as in effect for the calendar year 1953, is Section 105-134 of the General Statutes of North Carolina. It provides, in part, as follows:

"I. Foreign Corporations.

"Every foreign corporation doing business in this State shall pay annually an income tax equivalent to six per cent of a proportion of its entire net income, to be determined according to the following rules:

* * *

"3. If the principal business in this State of a corporation is other than that described in Subsection 1 or Subsection 2 of Subdivision II of this Section, then the total income of such corporation shall be apportioned to North Carolina on the basis of the ratio of its gross receipts in this State during the income year to its gross receipts for such year within and without the State.

"(a) The words 'gross receipts' as used in this subsection shall be taken to mean and include the entire receipts for business done by such company.

"4. If any corporation believes that the method of allocation or apportionment hereinbefore described as administered by the Commissioner of Revenue has operated or will so operate as to subject it to taxation on a greater portion of its net income than is reasonably attributable to business or earnings within the State, it shall be entitled to file with the Tax Review Board a petition setting forth the facts upon which its belief is based and its argument with respect to the application of the allocation formula. This petition

shall be filed in such form and within such time as the Tax Review Board may prescribe. The Board shall grant a hearing thereon. At least two members of the Tax Review Board shall attend any hearing pursuant to such petition. An informal record containing in substance the evidence, contentions and argument presented at the hearing shall be made. All three members of the Board shall consider such evidence, contentions and arguments, and the decision thereon shall be made by a majority vote of the Board. If the Board shall find that the application of the allocation formula subjects the corporation to taxation on a greater portion of its income or earnings than is reasonably attributable to its business or earnings within this State:

"(a) The Board shall be authorized to add to the factors of the applicable allocation formula or substitute for one of such factors, depending upon whether such addition or substitution in the opinion of the Board, more accurately reflects the income attributable to this State, the following factor: The ratio of all salaries, wages, commissions and other compensation paid or incurred by the taxpayer in this State for services performed in connection with the trade or business of the taxpayer during the income year to the total salaries, wages, commissions and other compensation paid or incurred by the taxpayer in connection with its entire trade or business wherever conducted during the income year. For the purpose of this Section all salaries, wages, commissions and other compensation paid to residents of North Carolina shall be deemed to have been paid or incurred in this State irrespective of the place of actual payment.

"(b) If the corporation shall employ in its books of account a detailed allocation of receipts and expenditures

which reflects more clearly than the applicable allocation formula or alternative formulas prescribed by this Section the income attributable to the business within this State, application for permission to base the return upon the taxpayer's books of account shall be considered by the Tax Review Board. The Board shall be authorized to permit such separate accounting method in lieu of applying the applicable allocation formula if the Board deems such method proper as best reflecting the income and earnings attributable to this State.

(c) If the corporation shall show that any other method of allocation than the applicable allocation formula or alternative formulas prescribed by this Section reflects more clearly the income attributable to the business within this State, application for permission to base the return upon such other method shall be considered by the Tax Review Board. The application shall be accompanied by a statement setting forth in detail, with full explanations, the method the taxpayer believes will more nearly reflect its income from business within this State. If the Board shall conclude that the allocation formula and the alternative formulas prescribed by this Section allocate to this State a greater portion of the net income of the corporation than is reasonably attributable to business or earnings within this State, it shall determine the allocable net income by such other method as it shall find best calculated to assign to this State for taxation the portion of the net income of the corporation reasonably attributable to its business or earnings within this State.

There shall be a presumption that the appropriate allocation formula reasonably attributes to this State the portion of the corporation's income earned in this State and the burden shall rest upon the corporation to show the contrary.

The relief herein authorized shall be granted by the Board only in cases of clear, cogent and convincing proof that the petitioning taxpayer is entitled thereto. No corporation shall use any alternative formula or method other than the applicable allocation formula provided by statute in making a report or return of its income to this State except upon order in writing of the Board and any return in which any alternative formula or other method other than the applicable allocation formula prescribed by statutes is used without the permission of the Board, shall not be a lawful return.

"When the Board determines, pursuant to the provisions of this Article, that an alternative formula or other method more accurately reflects the income allocable to North Carolina and renders its decision with regard thereto, the corporation shall allocate its net income for future years, in accordance with such determination and decision of the Board so long as the conditions constituting the basis upon which the decision was made remain unchanged or until such time as the business method of operation of the corporation changes. Provided, however, that the Commissioner of Revenue may, in his discretion, with respect to any subsequent year, require the corporation to furnish information relating to its property, operations and activities."

2. The Procedural Section

The procedural section under which this suit was brought is Section 105-267 of the General Statutes of North Carolina, and that section as then in effect is as follows:

"No court of this State shall entertain a suit of any kind brought for the purpose of preventing the collection of any tax imposed in this Act. Whenever a person shall have a valid defense to the enforcement of the collection of a tax

assessed or charged against him or his property, such person shall pay such tax to the proper officer, and notify such officer in writing that he pays the same under protest. Such payment shall be without prejudice to any defense of rights he may have in the premises, and he may, at any time within thirty days after such payment, demand the same in writing from the Commissioner of Revenue of the State, if a State tax, or if a county, city or town tax, from the treasurer thereof for the benefit or under the authority or by request of which the same was levied, and if the same shall not be refunded within ninety days thereafter, may sue such official in the courts of the State for the amount so demanded. Such suit, if against the State Commissioner of Revenue must be brought in the Superior Court of Wake County, or in the county in which the taxpayer resides, if the sum demanded is upwards of two hundred dollars ($200.00), and if for two hundred dollars ($200.00) or less, before any State court of competent jurisdiction in Wake County. If for a county, city or town tax, suit must be brought in a State court of competent jurisdiction in the county where the tax is collectible, and the defendant official has his official residence. If upon the trial it shall be determined that such tax or any part thereof was levied or assessed for an illegal or unauthorized purpose, or was for any reason invalid or excessive, judgment shall be rendered therefor, with interest, and the same shall be collected as in other cases. The amount of State taxes for which judgment shall be rendered in such action shall be refunded by the State. *Provided*, nothing in this Section shall be construed to conflict with or supersede the provisions of Section 912B.

APPENDIX B

Judgment of the Superior Court of Wake County, North Carolina

THIS CAUSE coming on to be heard, and being heard before the undersigned Judge of the Superior Court, Judge Presiding at the June 1960 Civil Term of Wake County Superior Court, and being heard without the intervention of a jury upon stipulation in open court by counsel for both parties that the Court could hear the evidence, find the facts and conclusions of law and render judgment accordingly, and the parties, through their respective counsel, having further stipulated in open court that judgment might be rendered and signed out of term and out of the district, and the Court having considered the pleadings, all of the evidence and exhibits and having heard arguments of counsel and considered written briefs filed by both parties, makes the following findings of fact:

1. That the plaintiff, Virginia Electric and Power Company, hereinafter referred to as VEPCO, is a Virginia corporation authorized to do business in North Carolina and is a public utility engaged in the business of generating electricity, and transmitting and distributing, and selling the same to the public. It operates in the States of Virginia, West Virginia and North Carolina; its operations in North Carolina being confined to the northeastern section thereof. It also distributes gas in the Hampton Roads area of Virginia, but it does not conduct any gas business in North Carolina.

2. The defendant, James S. Currie, is the duly appointed and acting Commissioner of Revenues of North Carolina and has been duly substituted as party defendant for Eugene G. Shaw, who was the duly appointed and acting Commis-

sioner of Revenue of North Carolina at the time of the institution of this action and who was then charged, as is now the substituted defendant, with the assessment and collection of taxes due the State of North Carolina in accordance with the Revenue Laws of North Carolina.

3. That this is an action instituted by the plaintiff under G. S. 105-267 to recover of the defendant income taxes in the amount of $46,521.43 and interest in the amount of $3,721.71 paid to the defendant on or about August 18, 1955, under protest with written demand for refund of same made on the defendant within thirty days thereof, and none of said amount paid under protest has been refunded; that the amount of $50,243.14, the total of the two figures hereinbefore mentioned, is the amount which the plaintiff seeks to recover in this action, with interest thereon at the rate of six per cent from August 18, 1955, until paid.

4. That the plaintiff was a corporation doing business in North Carolina during the year 1953 and was subject to the North Carolina income tax imposed on Foreign Corporations by G. S. 105-134-II(3), and the plaintiff on April 9, 1954 (the Commissioner on March 13, 1954, having granted an extension of time to file), filed a North Carolina income tax return on the basis of the statutory allocation formula established by G. S. 105-134-II(3), showing its total net income from Electric Operations as $17,705,415 and the proportion of its Electric Operations net income attributable to North Carolina under the gross receipts taxation formula as $1,292,911 or 7.302351% and income tax due and payable to the State of North Carolina in the amount of $77,574.66; no tax was paid by VEPCO with this return filed on the gross receipts basis. The statutory formula for apportionment of multi-state income applicable to VEPCO for the year 1953 is the ratio of its gross receipts in North

Carolina from its unitary business to its gross receipts wit' in and without the State from its unitary business.

5. On April 9, 1954, VEPCO filed another income tax return with the State of North Carolina on a separate accounting basis devised by VEPCO and showing $317,114 of the net income from its Electric Operations attributable to income produced from business done in North Carolina during the year 1953, which represented 1.791057% of its total net income of $17,705,415 from its Electric Operations, and showing an income tax due the State of North Carolina for the year 1953 in the amount of $19,026.84; this amount was paid to the State of North Carolina with the return filed on the basis of VEPCO's separate accounting.

6. For the year 1953, the total gross receipts of VEPCO from its Electric Operations everywhere was $79,904,007, and its total gross receipts in North Carolina were $5,834,871, or 7.302351% of its gross receipts from all of its Electric Operations; the total payroll of VEPCO for its Electric Operations everywhere was $19,246,057, and its total payroll in North Carolina for that year was $969,651, or 5.038180% of its total payroll for Electric Operations everywhere; that the average of VEPCO's gross receipts and payroll ratios for the State of North Carolina for the year 1953 was 6.170266%.

7. At the same time that VEPCO paid income tax to the State of North Carolina for the year 1953 in the amount of $19,026.84 on its separate accounting, VEPCO filed a petition with the North Carolina Tax Review Board asking authority to pay its tax on a separate accounting basis or, in the alternative, on the basis of substitution of the payroll formula for the gross receipts formula or, as a third alternative, in the event neither of the first two alternatives was granted, to allow VEPCO to pay an income

tax to the State of North Carolina for the year 1953 based on the substitution of the average of the gross receipts and payroll ratios for the statutory formula provided in G. S. 105-134-11(3).

8. The Tax Review Board of North Carolina is an administrative agency duly created and established by the General Assembly of North Carolina and was, at all times relevant to this action, vested with the authority and power under G. S. 105-134-11(4) of varying within limitations the statutory income apportionment formula applicable to any particular multi-state corporation upon a showing by "clear, cogent and convincing proof" that the applicable statutory allocation or apportionment formula would subject the taxpayer ". . . to taxation on a greater portion of its net income than is reasonably attributable to business or earnings within this State . . ." and upon a further showing by the petitioning taxpayer that it is, by the same standard of proof, entitled to the relief prayed for.

9. The Tax Review Board, after hearing on June 28, 1955, issued its Administrative Order No. 27 permitting VEPCO to substitute for the statutory gross receipts formula applicable to it the average of the gross receipts and payroll ratios, thus granting VEPCO's third alternative prayer for relief in its petition filed with the Tax Review Board. This resulted in allocated North Carolina net income for the tax year 1953 of $1,092,471 and in total income tax due North Carolina of $65,548.27. The plaintiff duly filed exceptions to the decision of the Tax Review Board, which exceptions were overruled by the Board. The decision of the Tax Review Board was not appealed to the Superior Court.

10. The defendant thereupon assessed VEPCO with additional income tax for the tax year 1953 in the amount

of $46,521.43, plus interest in the amount of $3,721.71, for a total of $50,243.14. This amount was paid under protest by the plaintiff on August 18, 1955, and demand for refund was made by the plaintiff upon the defendant on August 30, 1955, and refund was refused by the defendant, and more than ninety days from the date of such refusal had elapsed at the time of the institution of this action for refund.

11. The separate accounting system devised by VEPCO was developed primarily for rate making purposes with some adjustments for income tax purposes. It has been accepted for rate making purposes in the three states in which VEPCO operates, and the rates in the three states in which it operates are substantially uniform. Its separate accounting system is based upon numerous and varying allocation formulas, some of which are based upon a combination of all allocations.

12. The Electric Operation of VEPCO is an integrated system with unity of ownership, management, production and distribution of electrical power, and it is not known by the company whether a unit of electrical energy generated in North Carolina will be sold in Virginia or whether a unit generated in Virginia will be consumed in North Carolina or West Virginia, nor in which state such expense items as leakage really occur or to which state such items should be charged. The business of generating, distributing and selling electric energy conducted in North Carolina by VEPCO contributes to the success of the over-all Electric Operation of VEPCO in generating, distributing and selling electric energy in Virginia and West Virginia.

13. VEPCO has failed to show by clear, cogent and convincing evidence that the statutory allocation formula

(gross receipts; G. S. 105-134-H(3)) applicable to it or the allocation formula which it was permitted to use by order of the Tax Review Board (average of the gross receipts and payroll ratios; G. S. 105-134-H(4)) subjects the company to taxation by North Carolina on a greater proportion of its net income or earnings than is reasonably attributable to its business or earnings within North Carolina.

14. VEPCO has failed to show that the Tax Review Board abused its statutory discretion or acted arbitrarily and unlawfully in granting to VEPCO one of its alternative prayers for relief in permitting a substitution of a combination of allocation formulas for the statutory formula by allowing VEPCO to allocate to this State a portion of its net taxable income from its Electric Operation on a formula based upon the arithmetical average of the gross receipts and payroll (salaries and wages) ratios.

15. VEPCO has failed to show by clear, cogent and convincing evidence that its separate accounting method reflects more clearly the income reasonably attributable to its business or earnings in North Carolina than does the applicable statutory formula or the alternative allocation formula which it was permitted to use by order of the Tax Review Board.

And, upon the foregoing findings of fact, the Court concludes as a matter of law:

1. That VEPCO was not entitled to base its income tax return and payment of its income tax for the year 1953 on its separate accounting method;

2. That the Tax Review Board did not abuse the discretion vested in it by the General Assembly and did not act

arbitrarily, unreasonably or unlawfully in permitting VEPCO to use an alternative allocation formula based upon the arithmetical average of its gross receipts and salaries and wages ratios in determining the portion of its income reasonably attributable to its business or earnings within North Carolina for income tax purposes for the year 1953;

3. That the Commissioner of Revenue, in assessing the additional income tax which VEPCO seeks to recover by this action, had no alternative other than to follow the order of the Tax Review Board permitting VEPCO to use the alternative formula in computing the portion of its net income reasonably attributable to its North Carolina business for the 1953 income tax year;

4. That the action of the Tax Review Board and the defendant's assessment were in compliance with G. S. 105-134, and such action and the section on which it was based, do not constitute, as applied to the plaintiff, an undue burden on interstate commerce in violation of the Fourteenth Amendment or the Commerce Clause of the United States Constitution;

5. That the plaintiff, VEPCO, is not entitled to recover anything by this action.

NOW, THEREFORE, IT IS ORDERED, ADJUDGED AND DECREED that the plaintiff take nothing by this action; that this action be dismissed and that the costs be taxed against the plaintiff.

This 3rd day of September, 1960.

HAMILTON H. HOBGOOD
Judge Presiding at the June 1960
Civil Term of Wake County
Superior Court

APPENDIX C

Statement and Opinion of the Supreme Court of North Carolina

Civil action, by virtue of G. S. §105-267, against the State Commissioner of Revenue, to recover an additional income tax of $46,521.43, plus $3,721.71 interest, totaling $50,243.14, for the year 1953, paid under protest.

The parties, pursuant to G. S. §§1-184, 1-185, waived trial by jury, and agreed that the judge might find the facts, make conclusions of law, and render judgment thereon.

The facts found by the judge, which are material and essential to a decision of this appeal, are summarized, except when quoted:

Virginia Electric and Power Company, hereafter called VEPCO, is a Virginia corporation engaged in the year 1953 in the business of generating electricity, and transmitting, distributing and selling the same in the States of Virginia, West Virginia, and the northeastern part of North Carolina. It distributes gas only in the Hampton Roads area of Virginia. (The undisputed evidence, though not incorporated in the findings of fact, shows that the North Carolina Tax Review Board by Administrative Order No. 27 held that the operation of the gas business by VEPCO in Virginia was not a part of the company's unitary business in North Carolina, and directed that net income from such part of its business be excluded from income apportionable to North Carolina).

On 9 April 1954, following an extension of time given by defendant to file its income tax return for 1953, VEPCO, pursuant to the provisions of G. S. §105-134, II, Foreign Corporations, 3, in force in 1953, filed a North Carolina income tax return based on the statutory allocation formula there set forth. This return stated that VEPCO's total gross

income for 1953 was $79,911,518, its total allowable expenses for the year $62,206,103, its total net income, electric department, $17,705,415, the proportion taxable in North Carolina 7.302351%, $1,292,911, its total tax due at 6%, $77,574.66. VEPCO paid no tax on this return.

On the same day VEPCO filed another North Carolina income tax return stating its total gross income for 1953 was $5,835,719, its total allowable expenses for the year $5,518,605, its total net income $317,114, proportion taxable in North Carolina 100%, its total tax due at 6% $19,026.84, interest due $52.13, total amount due $19,078.97. VEPCO paid to the State on this return $19,078.97.

(These returns were introduced in evidence by VEPCO. The return upon which no tax was paid is plaintiff's Exhibit 1, and the return upon which $19,078.97 was paid is its Exhibit 2. We have stated the contents of these returns somewhat more fully than set forth in the findings to avoid setting them forth later. We believe what we have done is in the interest of clarity.)

At the time VEPCO paid to the State of North Carolina income tax in the amount of $19,078.97, it "filed a petition with the North Carolina Tax Review Board asking authority to pay its tax on a separate accounting basis or, in the alternative, on the basis of substitution of the payroll formula for the gross receipts formula or, as a third alternative, in the event neither of the first two alternatives was granted, to allow VEPCO to pay an income tax to the State of North Carolina for the year 1953 based on the substitution of the average of the gross receipts and payroll ratios for the statutory formula provided in G. S. 105-134-11(3)."

This is the petition summarized in the findings of fact:

"1. The Company is a Virginia Corporation duly qualified to do business in North Carolina. It conducts an electric

utility business in Northeastern North Carolina. Its principal North Carolina office is located at Williamston.

"2. The Company is subject to the North Carolina income tax. As a foreign corporation, it is required, in accordance with North Carolina General Statutes, § 105-134-11, to 'pay annually an income tax equivalent to six per cent of a proportion of its entire net income' determined in accordance with the gross receipts formula contained in paragraph (3) of that subsection. If the Company's entire net income from electric operations for 1953 were apportioned in accordance with this formula, net income of $1,292,911 would be allocated to North Carolina and the tax would be $77,574.66. The details of this computation are shown on Exhibit 1. The Company believes that such apportionment operates to subject it to taxation on a greater portion of its net income than is reasonably attributable to business or earnings within North Carolina for the reasons herein stated. The Company's service area in North Carolina covers the extreme northeastern section of the state which is predominantly agricultural and, as a consequence, thinly populated. The largest incorporated community served in North Carolina is Roanoke Rapids with a population of 8,156 (1950 census). By contrast the Company serves most of the major population centers in Virginia, including the Richmond, Petersburg, Hopewell area; the Norfolk, Portsmouth, Newport News area; and the Arlington, Alexandria, Fairfax area. The Company during 1953 had uniform rates throughout the territory served, with minor exceptions not here material. As a consequence it is obvious that the Company's operations are relatively more profitable in Virginia than in North Carolina. To further illustrate this point there were 24 customers per mile of distribution line in Virginia and West Virginia at December 31, 1953 as com-

pared with 10 in North Carolina. The investment in distribution facilities in North Carolina per customer amounted to $401 at December 31, 1953 as compared with an investment of only $266 in Virginia and West Virginia. Any additional evidence furnished comparing the operations of the Company in Virginia and West Virginia with North Carolina could only add weight to the Company's contention that the apportionment of net income to North Carolina on the basis of the gross receipts formula prescribed in §105-134-11(3) of the North Carolina General Statutes must operate to subject it to taxation on a greater portion of its net income than is reasonably attributable to business or earnings within North Carolina.

"3. The Company maintains in its books of account a detailed allocation of receipts and expenditures attributable to its North Carolina operations. These detailed allocations, in the opinion of the Company, reflect more clearly than the applicable allocation formula or alternative formulas prescribed by the statute the income attributable to the business of the Company in North Carolina. A statement of this computation is shown on Exhibit 2. Net income in 1953 from North Carolina operations so determined would be $317,114, and the tax would be $19,026.84. The Company is of the view that the separate accounting method is proper and best reflects its income and earnings attributable to North Carolina and that the Board should permit the Company to follow the separate accounting method as authorized by §105-134-11(4) of the North Carolina Statutes in filing its return.

"4. The Company has ascertained the ratio of all salaries, wages, commissions and other compensation paid or incurred by it in North Carolina for services during 1953 to total

salaries, wages, commissions and other compensation paid by it in connection with its electric business. If the factor so determined were substituted for the gross receipts factor and applied to the Company's 1953 net income from its electric operations, as authorized by § 105-134-11(4) of the North Carolina Statutes net income of $892,031 would be allocated to North Carolina and the resulting tax would be $53,521.86. The details of this computation are shown on Exhibit 3 Section I. The Company submits that allocation on this basis, while not as just, fair or proper as the separate accounting basis, is obviously more equitable in view of the facts of this case than allocation by the gross receipts factor.

"5. If the wage factor were averaged with the gross receipts factor rather than substituted for such factor, as set forth in paragraph 4 above, and applied to the Company's 1953 net income from its electric operations, as authorized by § 105-134-11(4) of the North Carolina Statutes net income of $1,092,471 would be allocated to North Carolina and the resulting tax would be $65,548.26, as shown on Exhibit 3, Section II. While the allocation on this basis is not as just, fair or proper as the separate accounting method or as equitable as the use of the wage factor alone it is, nonetheless more equitable than allocation by use of the gross receipts factor alone.

"The Company, accordingly, petitions the Board for relief as follows:

"(1) That the Board authorize the Company to file its return and pay its income tax for 1953 in accordance with the separate accounting method shown on Exhibit 2 as permitted by General Statutes, § 105-134-11(4) (b); or

"(2) If the prayer contained in (1) is not granted: (a) the Board authorize the Company to file its return and pay its income tax for 1953 in accordance with the allocation

based on the substitution of the wages factor for the gross receipts factor as permitted by General Statutes, § 105-134-11(4) (a), as shown on Exhibit 3, Section I; or (b) in the alternative the Board authorize the Company to file its return and pay its income tax for 1953 in accordance with the allocation based on the average of the wages and gross receipts factors as permitted by General Statutes, § 105-134-11(4) (a), as shown on Exhibit 3, Section II."

We insert the petition here rather than later on in the interest of clarity. It is dated 9 April 1954.

"For the year 1953, the total gross receipts of VEPCO from its Electric Operations everywhere was $79,904,007, and its total gross receipts in North Carolina were $5,834,871, or 7.302351% of its gross receipts from all of its Electric Operations; the total payroll of VEPCO for its Electric Operations everywhere was $19,246,057, and its total payroll in North Carolina for that year was $969,651, or 5.038180% of its total payroll for Electric Operations everywhere; that the average of VEPCO's gross receipts and payroll ratios for the State of North Carolina for the year 1953 was 6.170266%."

"The Tax Review Board of North Carolina is an administrative agency duly created and established by the General Assembly of North Carolina and was, at all times relevant to this action, vested with the authority and power under G. S. 105-134-11(4) of varying within limitations the statutory income apportionment formula applicable to any particular multi-state corporation upon a showing by 'clear, cogent and convincing proof' that the applicable statutory allocation or apportionment formula would subject the taxpayer '* * * to taxation on a greater portion of its net income than is reasonably attributable to business earnings with

this State * * *' and upon a further showing by the petitioning taxpayer that it is, by the same standard of proof, entitled to the relief prayed for."

"The Tax Review Board, after hearing on June 28, 1955, issued its Administrative Order No. 27 permitting VEPCO to substitute, for the statutory gross receipts formula applicable to it the average of the gross receipts and payroll ratios, thus granting VEPCO's third alternative prayer for relief in its petition filed with the Tax Review Board. This resulted in allocated North Carolina net income for the tax year 1953 of $1,092,471 and in total income tax due North Carolina of $65,548.27. The plaintiff duly filed exceptions to the decision of the Tax Review Board, which exceptions were overruled by the Board. The decision of the Tax Review Board was not appealed to the Superior Court.".

This is the decision of the North Carolina Tax Review Board, which is referred to in the finding of fact, and which we insert here rather than later in the interest of clarity:

"At a meeting of the Tax Review Board held in the City of Raleigh on July 29, 1955, the full membership of the Board formally considered the *Exceptions to Findings* which were filed with the Board on July 27, 1955, on behalf of the Virginia Electric and Power Company pursuant to G. S. 105-163, such exceptions having been made to the findings and determinations of the Tax Review Board, insofar as they relate to the income years 1953, 1954 and subsequent years, contained in Administrative Order No. 27 entered June 28, 1955.

"In giving full consideration to the matter, the Board at the aforesaid meeting found and determined:

"1. That Virginia Electric and Power Company (hereinafter referred to as the Company) filed separate petitions before the Tax Review Board on November 30, 1953, April 12, 1954, and March 16, 1955 concerning the allocation of its net income for the income years 1952, 1953 and 1954 respectively. That after hearings had been duly held on said petitions, the Board, at a meeting on June 28, 1955 gave full consideration to evidence, contentions and arguments as set forth in the above-mentioned petitions and hearings, and entered its Administrative Order No. 27 covering taxable years 1952, 1953, 1954 and subsequent years, granting the taxpayer-company one of its alternative prayers for relief.

"2. That in each of the said petitions, the Company requested that it be authorized to report income to this State on the basis of separate accounting as permitted by G. S. 105-134, II, 4(b), or, in the event such relief could not be granted, that it be authorized to allocate income to this State either by substituting the wage factor for the gross receipts factor, or by adding the wage factor to the gross receipts factor, as permitted by G. S. 105-134, II, 4(a).

"3. That on the basis of all the evidence, contentions and arguments set forth in the petitions, records, and hearings, the Board concluded that the applicable statutory provision, G. S. 105-134, II, 3, which required the Company to apportion its income according to the gross receipts formula described therein, had operated and would so operate as to subject the Company to taxation in this State on a greater portion of its net income than could reasonably be attributed to business or earnings within this State.

"4. That accordingly, the Board, in its Administrative Order No. 27, granted to the Company the alternative relief requested in each of its petitions, by authorizing the Com-

pany to allocate its income for income tax purposes on the basis of a ratio obtained by adding a salaries and wages factor to the gross receipts factor as permitted by G. S. 105-134, 11, 4(a).

"5. And, that although such relief was in accordance with one of the alternative prayers for relief asked by the Company in each of its above-mentioned petitions, on July 27, 1955, the Company filed formal exceptions to the findings and determinations of the Board, as they relate to income years 1953, 1954 and subsequent years, contained in Administrative Order No. 27, on the grounds

"'(1) The allocation of net income to North Carolina on the basis of the arithmetical average of the gross receipts ratio and the salaries and wages ratio subjects the Company to income taxation by North Carolina on a greater portion of its net income than is reasonably attributable to business or earnings within the State of North Carolina.

"'(2) The Company employs on its books of account a detailed allocation of receipts and expenditures which reflects more clearly than any allocation formula prescribed by G. S. Sec. 105-134 the income attributable to its business within the State of North Carolina. Such separate accounting best reflects the income and earnings of the Company attributable to North Carolina. The Board was in error in refusing to permit the determination of income subject to the North Carolina income tax on the basis of such separate accounting method rather than on the basis of an allocation formula.'

"The Tax Review Board, having formally passed upon the above-quoted exceptions pursuant to G. S. 105-163, hereby makes the following rulings:

"1. That the Board was correct in its finding as stated in Administrative Order No. 27 that the application of the formula required by G. S. 105-134, II subsection 3 has operated and will so operate as to subject the Company to taxation on a greater portion of its net income than is reasonably attributable to business or earnings within this State, and

"2. That the Board was correct in finding that the allocation of the Company's net income to North Carolina on the basis of the arithmetical average of the gross receipts ratio and the salaries and wages ratio

"(a) more accurately reflects the Company's net income attributable to this State than does the applicable statutory formula (i. e. the formula required by G. S. 105-134, II subsection 3), and

"(b) more accurately reflects the Company's net income attributable to this State than would the substitution of the salaries and wages factor for the gross receipts factor, as authorized by G. S. 105-134, II subsection 4(a), and

"3. That therefore, the Board was acting within its authority as set out in G. S. 105-134, II subsection 4 in granting its Administrative Order No. 27 the aforementioned relief, for which the petitioner asked in its alternative prayer for relief, and to which the Board found the petitioner entitled."

Whereupon, defendant assessed VEPCO with additional State income tax for 1953 in the amount of $46,521.43 ($65,548.27 less $19,026.84 makes $46,521.43), plus $3,721.71 for interest, for a total of $50,243.14. Plaintiff paid this additional State income tax, and has followed the statutory procedure to sue for its recovery.

The separate accounting system devised by VEPCO was developed primarily for rate making purposes with some adjustments for income tax purposes. It has been accepted for rate making purposes by the three States in which it operates. This separate accounting system is based upon numerous and varying allocation formulas, some of which are based upon a combination of allocations.

The electrical operation of VEPCO is an integrated system with unity of ownership, management, and production and distribution of electrical power. It is not known by VEPCO whether a unit of electric energy generated in North Carolina or in Virginia will be sold in Virginia, West Virginia or North Carolina; nor in which States expense items such as leakage occur, nor to which State such a leakage item should be charged. The electric business done by VEPCO in North Carolina contributes to the success of the overall electric operations of VEPCO in the three States.

VEPCO has failed to show by clear, cogent and convincing proof that the allocation formula (allocation based on the average of the wages and gross receipts factors as permitted by G. S. 105-134-11, 4), which the State Tax Review Board permitted it to use, as requested by it in one of its alternative prayers for relief in its petition for review of apportionment of net income, year 1953, filed with the State Tax Review Board, (and above set forth), subjects VEPCO to taxation by North Carolina on a greater proportion of its net income than is reasonably attributable to its earnings or business in North Carolina.

VEPCO has failed to show that the State Tax Review Board abused its statutory discretion, or acted arbitrarily, or unlawfully in permitting it to use the allocation formula it requested in one of its alternative prayers for relief as above set forth.

VEPCO has failed to show by clear, cogent and convincing proof that its separate accounting system reflects more clearly the income attributable to its business in North Carolina than does the allocation formula, which the State Board of Tax Review permitted it to use at its request, as above set forth.

Based upon its findings of fact the judge made the following conclusions of law:

"1. That VEPCO was not entitled to base its income tax return and payment of its income tax for the year 1953 on its separate accounting method.

"2. That the Tax Review Board did not abuse the discretion vested in it by the General Assembly and did not act arbitrarily, unreasonably or unlawfully in permitting VEPCO to use an alternative allocation formula based upon the arithmetical average of its gross receipts and salaries and wages ratios in determining the portion of its income reasonably attributable to its business or earnings within North Carolina for income tax purposes for the year 1953.

"3. That the Commissioner of Revenue, in assessing the additional income tax which VEPCO seeks to recover by this action, had no alternative other than to follow the order of the Tax Review Board permitting VEPCO to use the alternative formula in computing the portion of its net income reasonably attributable to its North Carolina business for the 1953 income tax year.

"4. That the action of the Tax Review Board and the defendant's assessment were in compliance with G. S. 105-134, and such action and the section on which it was based, do not constitute, as applied to the plaintiff, an undue burden on interstate commerce in violation of the Fourteenth

Amendment or the Commerce Clause of the United States Constitution.

"5. That the plaintiff, VEPCO, is not entitled to recover anything by this action."

Whereupon the judge adjudged and decreed that VEPCO recover nothing, and dismissed the action, taxing VEPCO with the costs.

From the judgment VEPCO appealed.

PARKER, Justice.

The standard to be applied in a suit to recover a state tax paid under protest is set forth in G. S. § 105-267. The relevant part of the statute is: "If upon the trial it shall be determined that such tax or any part thereof * * *, was for any reason invalid or excessive, judgment shall be rendered therefor, with interest, and the same shall be collected as in other cases."

G. S. § 105-134 in effect during the year 1953 is applicable here, not G. S. 105-134 as it now appears due to changes made in later years by the Legislature. VEPCO's brief is based on G. S. § 105-134 in force for the year 1953.

Since VEPCO operates in three States, its net income must be allocated to North Carolina. A state in attempting to put upon a business extending into several states "its fair share of the burden of taxation" is "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113, 41 S. Ct. 45, 47, 65 L. Ed. 165, and as a matter of practical tax administration it has been "declared that 'rough approximation rather than precision' is sufficient." International Harvester Co. v. Evatt, 329 U. S. 416, 422, 67 S. Ct. 444, 447, 91 L. Ed. 390, 395.

The statutory allocation formula applicable to VEPCO for the year 1953 is set forth in G. S. 105-134-11-3, in force in 1953 as follows: "The total income of such corporation shall be apportioned to North Carolina on the basis of the ratio of its gross receipts in this state during the income year to its gross receipts for such year within and without the state."

For the year 1953 VEPCO filed a state income tax return in accord with the above statutory allocation formula showing tax due at 6% (G. S. 105-134-11) in the amount of $77,574.60. It did not pay this tax. The State Tax Review Board, after considering VEPCO's petition for review of apportionment of net income for the year 1953, in accordance with the powers vested in it by G. S. 105-134-11-4, upheld its contention that the statutory allocation formula, G. S. 105-134-11-3, has operated and will operate so as to subject VEPCO to taxation on a greater portion of its net income than is reasonably attributable to its business or earnings within the State. Whereupon, the State Board of Tax Review, acting pursuant to the powers vested in it, held that the allocation of VEPCO's net income to North Carolina on the basis of the arithmetical average of the gross receipts ratio and the salaries and wages ratio, as requested by VEPCO in its petition to the State Board of Tax Review in one of its prayers for alternative relief, and which would show a tax due to North Carolina in the sum of $65,548.26, more accurately reflects VEPCO's net income reasonably attributable to North Carolina than does the statutory allocation formula required by G. S. 105-134-11-3, and more accurately reflects VEPCO's net income reasonably attributable to this State than would the substitution of the salaries and wages factor as authorized by G. S. 105-134-11-4. Defendant assessed VEPCO with an income tax

of $65,548.26, less the amount of $19,078.97 it had already paid on one of the income tax returns it filed for the year 1953, in accordance with the allocation formula based on the gross receipts ratio and the salaries and wages ratio. It is to be noted that VEPCO in its petition, above set forth, states in respect to the allocation formula of its net income to North Carolina on the basis of the arithmetical average of the gross receipts and the salaries and wages ratio: "While the allocation on this basis is not as just, fair or proper as the separate accounting method or as equitable as the use of the wage factor alone it is, nonetheless more equitable than allocation by use of the gross receipts factor alone." VEPCO in this petition does not state, nor even intimate, that a State income tax levied in accord with this allocation formula would be excessive, or levied in accord with this allocation formula would be on a greater portion of its net income than is reasonably attributable to its business or earnings within this State.

VEPCO in its brief states two questions are presented for decision: One, was not the income tax exacted by defendant for the year 1953 excessive? Two, was not the exaction of the tax a deprivation of VEPCO's property without due process of law and an unconstitutional burden on interstate commerce?

Norfolk & W. R. Co. v. State of North Carolina, 297 U. S. 682, 56 S. Ct. 625, 628, 80 L. Ed. 977, was an action to recover back the amount of a state income tax paid by an interstate railroad company as having been improperly assessed. The Court said: "We must bear in mind steadily that the burden is on the taxpayer to make oppression manifest by clear and cogent evidence."

Butler Brothers v. McColgan, 315 U. S. 501, 62 S. Ct. 701, 704, 86 L. Ed. 991, was a suit to recover back a corpo-

rate franchise tax. In that case the Court says: "One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed."

VEPCO contends that the tax assessed under the allocation formula of the gross receipts ratio and the salaries and wages ratio is shown by its evidence to be excessive. Its evidence falls into two categories.

First. Its territory in northeastern North Carolina is largely agricultural and thinly settled. Its territory in Virginia includes the largest metropolitan areas. Its rates everywhere are the same. There are 24 customers per mile outside of North Carolina, and 10 in North Carolina. Investment in distribution facilities per customer is $401 in North Carolina, and $266 elsewhere. Each added dollar of investment means more taxes and depreciation, which must be deducted to reach net income. Revenue per kilowatt hour was $1.50 in North Carolina and $1.96 elsewhere. Taxes are heavier in North Carolina. Practically all of its generating facilities are in Virginia.

Second. VEPCO maintains in its books of account a detailed allocation of receipts and expenditures attributable to its North Carolina operations, which shows a net income of $317,114, and an income tax due to North Carolina for 1953 of $19,026.84.

A. M. Clement, assistant treasurer of VEPCO, testified that VEPCO keeps a detailed allocation of receipts and expenses which shows the income, attributable to its business in North Carolina, and that the State Utilities Commission considered the earnings of VEPCO thus shown in the rate case in which increases were granted in June 1954. That the test used in the rate case was the 12 months ended

30 September 1953. The data presented in the rate case were prepared on the same separate accounting basis for 1953. The rate of return is based on investment of VEPCO, and not on reproduction cost. The witness was asked a number of other questions in respect to whether the State Utilities Commission accepted these figures, but the judge sustained objections to the questions, though he permitted the witness to put his answers in the record. VEPCO excepted to the judge's rulings, but did not bring forward the exceptions, and discuss them in its brief. Under our rules such exceptions are deemed abandoned. Rule 28, Rules of Practice in the Supreme Court, 221 N. C. 544, 563; Waddell v. Carson, 245 N. C. 669, 97 S. E. 2d 222.

Robert S. Boyd, manager of the appraisal division of Stone & Webster Engineering Corporation, testified for VEPCO as an expert on matters of allocation of income. He expressed the opinion that the use of the formula insisted upon by defendant would attribute to North Carolina more income than is reasonably attributable to its operations in North Carolina, and in consequence would attribute to North Carolina income earned outside of North Carolina. He further stated that, in his opinion, VEPCO's books of account showing a detailed allocation of receipts and expenditures attributable to North Carolina would allot to North Carolina its proper share of VEPCO's net income.

John Deere Plow Co. of Moline v. Franchise Tax Board, 38 Cal. 2d 214, 238 P. 2d 569, 573, appeal dismissed for want of a substantial federal question, 343 U. S. 939, 72 S. Ct. 1036, 96 L. Ed. 1345, was an action to recover an additional franchise tax assessed against it for the year 1938, based upon income for the year 1937. Plaintiff argued that the formula used operated to distort the productivity of its California business, and cannot work properly in reason-

ably reflecting the proportionate part of the unitary income attributable to California. In reply to this argument, the Court said: "But in so arguing plaintiff fails to take into account the underlying concept of formula apportionment in the allocation of income from a unitary business: that the unitary income is derived from the functioning of the business as a whole, to which the activities in the various states contribute; and that by reason of such interrelated activities in the integrated overall enterprise, the business done within the state is not truly separate and distinct from the business done without the state so as reasonably to permit of a segregation of income under the separate accounting method rather than use of the formula method in assigning to the taxing state its fair share of taxable values."

VEPCO distributes gas only in the Hampton Roads area of Virginia. The North Carolina Tax Review Board by Administrative Order No. 27 held that this distribution of gas was not a part of VEPCO's unitary business, and directed that any net income from such gas business be excluded from income attributable to North Carolina.

"In the apportionment of a unitary business the formula used must give adequate weight to the essential elements responsible for the earning of the income, and must not include income unconnected with the unitary business, but its propriety in a given case does not require that the factors appropriately employed be equally productive in the taxing state as they are for the business as a whole. Varying conditions in the different states wherein the integrated parts of the whole business function must be expected to cause individual deviation from the general average of the factors in the formula equation in all the different states wherein the integrated parts of the whole business function, and yet the mutual dependency of the interrelated activities in

furtherance of the entire business sustains the apportionment process. John Deere Plow Co. v. Franchise Tax Board, supra; Ford Motor Co. v. Beauchamp, 308 U. S. 331, 60 S. Ct. 273, 84 L. Ed. 304; In the matter of The North American Cement Corporation v. Graves, 243 App. Div. 834, 278 N. Y. S. 920, in Court of Appeals 269 N. Y. 507, 199 N. E. 510, judgment affirmed 299 U. S. 517, 57 S. Ct. 311, 81 L. Ed. 381; Crane Co. v. Carson, 191 Tenn. 353, 234 S. W. 2d 644, certiorari denied 340 U. S. 906, 71 S. Ct. 282, 95 L. Ed. 655.

There is "no necessary inconsistency between the accuracy and fairness of the taxpayer's accounting and the different result obtained by the formula method of allocating income," Edison California Stores v. McColgan, 30 Cal. 2d 472, 483, 183 P. 2d 16, 23, since "a particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a state seeks to tax values created by business within its borders," Butler Brothers v. McColgan, 315 U. S. 501, 507, 62 S. Ct. 701, 704, 86 L. Ed. 991, 996, so that for "taxation purposes the one does not impeach the other," Edison California Stores v. McColgan, supra, at page 483 in the California reports, at page 23 in the Pacific Reporter.

It seems the only requirement is that that allocation formula used be not intrinsically arbitrary or produce an unreasonable result. Such was the situation in the case of Hans Rees' Sons v. State of North Carolina ex rel. Maxwell, 283 U. S. 123, 51 S. Ct. 385, 75 L. Ed. 879, where the Court recognized the unitary character of the business as a manufacturer and selling enterprise extending into several states and to which a formula method of apportionment was appropriate, but refused to approve the particular formula employed for the reason that it consisted simply

of the property factor and failed to give proper weight to the extensive activities of the company without the state, so that the result reached was unreasonable. See Butler Brothers v. McColgan, 17 Cal. 2d 664, 678, 111 P. 2d 334, 341, affirmed 315 U. S. 501; 62 S. Ct. 701, 86 L. Ed. 991.

VEPCO in its complaint has no allegation of any kind in respect to the consideration by the State Utilities Commission in fixing rates for its services of its books of account wherein are kept a detailed allocation of receipts and expenses showing the income attributable to its business in North Carolina. Neither has it favored us in its brief with any argument or discussion as to how such consideration is material here. The fixing of rates by the State Utilities Commission to be charged by VEPCO in North Carolina for its services, and the establishment by North Carolina of an allocation formula so that VEPCO will bear its fair share of the burden of taxation in North Carolina, are entirely different matters, and involve different factors.

VEPCO in the petition which it filed with the North Carolina Tax Review Board asking authority to pay its income tax to North Carolina on a separate accounting basis or, in the alternative, on the basis of substitution of the payroll formula for the gross receipts formula or, as a third alternative, in the event neither of the first two alternatives was granted, to allow it to pay an income tax to North Carolina for the year 1953 on the substitution of the average of the gross receipts and payroll ratios for the statutory formula, which petition is set out in full in the statement of facts, sets forth a large part of the facts shown in the first category of its evidence at the hearing before Judge Hobgood. It is reasonable to assume that the additional facts shown in the first category of its evidence before Judge Hobgood was known by VEPCO when it filed this petition. In this petition there is no suggestion or intimation that if

VEPCO was allowed to use the third alternative, the tax imposed would be excessive or the taxing of income not fairly attributable to its business in North Carolina. In this petition it is apparent that VEPCO took the position that though it could show by a separate accounting system, its activities in North Carolina were less profitable than those without North Carolina, and what the net earnings in North Carolina was according to its separate accounting system, it did not preclude the use of a formula as a method of apportionment of its unitary income. It is also apparent that VEPCO, when it requested that it be permitted to use the formula here used by defendant, thoroughly recognized the fact that its electric business in North Carolina was an integrated unit in its whole electric business, providing the advantages of a unitary business through unity of ownership, unity of operation by centralized purchasing, management, advertising and accounting, and unity of use in the centralized executive force and general system of operation.

Analyzing the evidence in the record before us, we are of the opinion, and so hold, that VEPCO has not carried the burden "to make * * * manifest by clear and cogent evidence" (Norfolk & W. R. Co. v. North Carolina, supra [297 U. S. 682, 56 S. Ct. 628]) that the additional income tax here imposed is excessive, or that it taxes VEPCO on net income not reasonably attributable to its business in North Carolina, or that the State Tax Review Board abused its statutory discretion, or acted arbitrarily or unlawfully in permitting it to use an allocation formula it requested permission to use. The income tax computed by defendant here on VEPCO for the year 1953 is not open to constitutional objections as operating to tax extraterritorial income in violation of the due process clause of the Fourteenth Amendment to the Federal Constitution, or as being an unconstitutional burden on interstate commerce.

There is competent evidence to support the essential findings of fact, which findings support the conclusions of law made by the hearing judge. It therefore follows that the trial judge properly sustained the additional income tax for 1953 assessed against VEPCO by defendant. All VEPCO's assignments of error are overruled.

The judgment is
Affirmed.

APPENDIX D

Judgment of the Supreme Court of North Carolina

This cause came on to be argued upon the transcript of the record from the Superior Court Wake County: Upon consideration whereof, this Court is of opinion that there is no error in the record and proceedings of said Superior Court.

It is therefore considered and adjudged by the Court here that the opinion of the Court as delivered by the Honorable R. Hunt Parker, Justice, be certified to the said Superior Court to the intent that the JUDGMENT IS AFFIRMED.

And it is considered and adjudged further, that the plaintiff do pay the costs of the appeal in this Court incurred, to wit, the sum of Thirty-Six and no/100 dollars ($36.00), and execution issue therefor.

Adrian J. Newton
Clerk of the Supreme Court

By Sarah G. Barbee, Deputy Clerk

Certified to Superior Court
this 10th day of February 1961.